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SUBJECT: SERBIA: 2007-2008 INCSR II ON MONEY LAUNDERING

REF: State 138130

SUMMARY

1. Reftel requested post update for Serbia on efforts to combat money laundering and terrorist financing. Serbia is upholding all international commitments to eliminate money laundering and terrorist financing. END SUMMARY.

SERBIA: Not a Financial Center

2. Serbia is not a regional financial center. At the crossroads of Europe and on the major trade corridor known as the "Balkan route," Serbia confronts narcotics trafficking, smuggling of persons, drugs, weapons and pirated goods, money laundering, and other criminal activities. Serbia continues to be a significant black market for smuggled goods. Illegal proceeds are generated from drug trafficking, corruption, tax evasion and organized crime, as well as other types of crimes. Proceeds from illegal activities are invested in all forms of real estate. Trade-based money laundering, in the form of over- and under-invoicing, is commonly used to launder money.

3. A significant volume of money flows to Cyprus, reportedly as the payment for goods and services. The records maintained by various government entities vary significantly on the volume and value of imports from Cyprus. According to Government of the Republic of Serbia (GOS) officials, much of the difference is due to payments made to accounts in Cyprus for goods, such as Russian oil, that actually originate in a third jurisdiction.

Banking Sector Largely Foreign Owned

4. Serbia's banking sector is more than 80 percent foreign-owned. There is no provision in the banking law that allows the establishment of offshore banks, shell companies or trusts. Reportedly, there is no official evidence of any alternative remittance systems operating in the country; however, there is anecdotal evidence. Nor, reportedly, is there evidence of financial institutions engaging in currency transactions involving international narcotics trafficking proceeds. Serbia has 14 designated free trade zones, three of which are in operation. The free trade zones were established to attract investment by providing tax-free areas to companies operating within them. These companies are subject to the same supervision as other businesses in the country.

Anti-Money Laundering Law

5. In September 2005, Serbia codified an expanded definition of money laundering in the Penal Code. This legislation gives police

and prosecutors more flexibility to pursue money laundering charges, as the law broadens the scope of money laundering and aims to conform to international standards. The penalty for money laundering is a maximum of 10 years imprisonment. Under this law and attendant procedure, money laundering falls into the serious crime category and permits the use of Mutual Legal Assistance (MLA) procedures to obtain information from abroad.

¶6. On November 28, 2005, Serbia adopted a revised anti-money laundering law (AMLL), replacing the July 2002 Law on the Prevention of Money Laundering. The revised AMLL expands the number of entities required to collect certain information on all cash transactions over EUR 15,000 (approx. \$21,750), or the dinar equivalent, and to file currency transaction reports (CTRs) for all such transactions exceeding this threshold with the financial intelligence unit (FIU). Suspicious transactions in any amount must be reported to the FIU. The law also expands those sectors subject to reporting and record keeping requirements. Banks, attorneys, auditors, tax advisors and accountants, currency exchanges, insurance companies, casinos, securities brokers, dealers in high value goods, real estate agencies and travel agents are required to comply with the AMLL provisions. Required records must be maintained for five years. These entities are protected with respect to their cooperation with law enforcement entities. The AMLL requires obligated entities and individuals to monitor customers' accounts when they have a suspicion of money laundering, in addition to reporting to the FIU. The AMLL also eliminates a previous provision limiting prosecution to crimes committed within Serbian territory. Significant improvement has been noted in financial institution compliance, i.e., gathering and keeping records on customers and transactions. The flow of information to the FIU has been steadily increasing, but not all entities are yet subject to implementing bylaws.

#### Law on Foreign Exchange

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¶7. The Law on Foreign Exchange Operations, adopted in 2006, criminalizes the use of false or inflated invoices or documents to affect the transfer of funds out of the country. This law was enacted in part to counter the perceived problem of import-export fraud and money laundering. According to the law, residents and nonresidents are obliged to declare to Customs authorities all currency (foreign or dinars), or securities in amounts exceeding EUR 5,000 (\$7,250) being transported across the border. The Foreign Currency Inspectorate, part of the Ministry of Finance, is responsible for supervising import/export companies for compliance.

¶8. The National Bank of Serbia (NBS) has supervisory authority over banks, currency exchanges, insurance and leasing companies. The NBS has issued regulations requiring banks to have compliance and know-your-customer (KYC) programs in place and to identify the beneficial owners of new accounts. In June 2006, the NBS expanded its customer identification and record keeping rules by adopting new regulations mandating enhanced due diligence procedures for certain high risk customers and politically exposed persons. Similar regulations are being developed for insurance companies. The Law on Banks includes a provision allowing the NBS to revoke a bank's license for activities related to, among other things, money laundering and terrorist financing. To date, the NBS has not used this revocation authority. The legal framework is in place, but the NBS is still building the capacities needed for effective bank supervision through training and staff development.

¶9. The Securities Commission (SC) supervises broker-dealers and investment funds. The Law on Investment Funds and the Law on Securities and Other Financial Instruments Market provide the SC with the authority to "examine" the source of investment capital during licensing procedures. The SC is also charged with monitoring its obligors' compliance with the AML Laws. Regulations to implement this authority are being developed.

#### Financial Intelligence Unit in Place

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¶10. The Administration for the Prevention of Money Laundering serves as Serbia's FIU. The revised AMLL elevates the status of the FIU to that of an administrative body under the Ministry of Finance. This provides more autonomy for the agency to carry out its mandate,

as well as additional resources. One important change is that the FIU now has its own line item operating budget. The FIU currently has 24 employees. In accordance with the revised AMLL, the FIU developed listings of suspicious activity red flags for banks, currency exchange offices, insurance companies, securities brokers and leasing companies. Other significant changes include the authority of the FIU to freeze transactions for a maximum of 72 hours. The FIU has signed memoranda of understanding (MOU) on the exchange of information with the NBS and Customs and is negotiating one with the Tax Administration.

¶11. For year-to-date, through November 19, 2007, the FIU received 1,572 suspicious transaction reports (STRs). Virtually all of the STRs received by the FIU have been filed by commercial banks. Currency exchange offices have filed only seven STRs, all prior to ¶2004. In 2007, the FIU has opened 46 cases; 119 cases were referred to law enforcement, investigative agencies or the prosecutor's office for further investigation. A total of six criminal charges have been submitted for money laundering violations this year. The most common predicate crime is "abuse of office". One final sentence has been issued in 2007.

VAT

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¶12. Serbia introduced a value-added tax (VAT) in 2005, and the full impact of refund fraud associated with the administration of the VAT is still not clear. Serbia's Tax Administration lacks the audit and investigative capacity or resources to adequately investigate the large number of suspicious transactions that are forwarded by Serbia's FIU. In addition, current tax law sets a low threshold for auditing purposes and has increased the burden on the Tax Administration. This creates a situation where criminals can spend and invest criminal proceeds freely with little fear of challenge by the tax authorities or other law enforcement agencies.

¶13. The difficulty of convicting a suspect of money laundering without a conviction for the predicate crime and the unwillingness of the courts to accept circumstantial evidence to support money laundering or tax evasion charges is hampering law enforcement and prosecutors in following the movement and investment of illegal proceeds and effectively using the anti-money laundering laws. The Suppression of Organized Crime Service (SOCS) of the Interior Ministry houses an Anti-Money Laundering Section to better focus financial investigations.

Interagency Working Group Established

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¶14. In August 2005, the GOS established the Permanent Coordinating Group (PCG), an interagency working group originally tasked with developing an implementation plan for the recommendations from MONEYVAL's first-round evaluation in October 2003. Subgroups have been tasked with drafting amendments to the AMLL that will bring the country's laws into compliance with the EU Third Directive on Money Laundering and with estimating the budget necessary to effectively implement the new law when it is enacted. The PCG and the working groups meet intermittently as required for completing specific tasks. The government still needs better, more consistent interagency coordination to improve information sharing, record keeping and statistics.

¶15. Under Serbian law, assets derived from criminal activity or suspected of involvement in the financing of terrorism can be confiscated upon conviction for an offense. The FIU is charged with enforcing the UNSCR 1267 provisions regarding suspected terrorist lists. A draft law on terrorist financing, now pending Parliamentary approval, will apply all provisions of the AMLL to terrorist financing, require reporting to the FIU of transactions suspected to be terrorist financing and will create mechanisms for freezing, seizing and confiscation of suspected terrorist assets based on UNSCR provisions. Although the FIU routinely provides the UN list of suspected terrorist organizations to the banking community, examinations for suspect accounts have revealed no evidence of terrorist financing within the banking system or any official evidence of alternative remittance systems. The SOCS, the Special Anti-Terrorist Unit (SAJ), and Gendarmarie, in the Interior Ministry, are the law enforcement bodies responsible for planning and conducting the most complex antiterrorism operations. SOCS

cooperates and shares information with its counterpart agencies in all of the countries bordering Serbia. Although Serbia has criminalized the financing of terrorism, the freezing, seizing and confiscation of assets of terrorists in accordance with UN Security Council resolutions still lacks a legal basis, pending enactment of the draft legislation.

#### Cooperation with Others

¶16. Serbia has no laws governing its cooperation with other governments related to narcotics, terrorism, or terrorist financing. Bases for cooperation include participation in Interpol, bilateral cooperation agreements, and agreements concerning international legal assistance. There are no laws at all governing the sharing of confiscated assets with other countries.

¶17. Serbia does not have a mutual legal assistance arrangement with the United States, but information exchange via a letter rogatory is standard. The 1902 extradition treaty between the Republic of Serbia and the United States remains in force. The GOS has bilateral agreements on mutual legal assistance with 31 countries. As a member of the Council of Europe, the GOS is an active member of the Council's MONEYVAL. In July 2003, the FIU became a member of the Egmont Group and actively participates in information exchanges with counterpart FIUs including FinCEN. The Serbian FIU has also signed information sharing memoranda of understanding (MOUs) with Macedonia, Romania, Belgium, Slovenia, Montenegro, Albania, Georgia, Ukraine, Bulgaria, Croatia, and Bosnia and Herzegovina. Serbia is a party to the 1988 UN Drug Convention and the UN Convention against Transnational Organized Crime. The GOS also is a party to all 12 UN Conventions and Protocols dealing with terrorism, including the UN International Convention for the Suppression of the Financing of Terrorism, although domestic implementation procedures do not provide the framework for full application. In December 2005, the GOS ratified the UN Convention against Corruption.

#### Next Steps

¶18. Serbia should continue to work toward eliminating the abuses of office and culture of corruption that enables money laundering and financial crimes. Among the pending legislative initiatives to make Serbia fully compliant with international standards are laws providing for the liability of legal persons for money laundering and terrorist financing; regulations to apply all requirements of the AMLL to covered non-bank financial institutions; legislation to establish a robust asset seizure and forfeiture regime; and legislation providing for the sharing of seized assets. Serbia also needs to enact and implement proposed legislation needed to comply with UN Security Council resolutions regarding the freezing, seizing and confiscation of suspected terrorist assets and require suspicions of terrorist financing to be reported to the FIU.

¶19. The National Bank and other supervisory bodies need training and additional staff. The GOS should enforce regulations pertaining to money service businesses and obligated non-financial businesses and professions. The supervisory scheme should be completed, and implementing regulations should be binding, for the insurance and securities sectors. On an operational level, law enforcement needs audit and investigative capacity in order to investigate the STRs that the FIU disseminates. Training is also required for prosecutors and judges. Rather than address specific tasks as an ad hoc group, the PCG should meet on a regular basis to discuss issues and projects, and work to improve interagency coordination in such areas as information sharing, record keeping and statistics.

#### Comment

¶20. Serbia is upholding all international commitments to eliminate money laundering and terrorist financing. Serbia continues to strengthen its anti-money laundering and terrorist financing law enforcement with the help of U.S. Department of Justice and Treasury's Embassy-based personnel from whom Serbian authorities have received training in organized crime investigation, prosecution, and adjudication. End Comment.

